

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

**Investigation of Terms and Conditions of Public Utility) Docket No. EL01-118-000
Market-Based Rate Authorizations**

**COMMENTS OF THE NEW ENGLAND CONFERENCE
OF PUBLIC UTILITIES COMMISSIONERS, VERMONT DEPARTMENT OF PUBLIC
SERVICE AND THE MICHIGAN PUBLIC SERVICE COMMISSION**

Pursuant to the Commission's notice of November 30, 2001, the New England Conference of Public Utilities Commissioners (NECPUC), the Vermont Department of Public Service, the State of Michigan and the Michigan Public Service Commission (collectively NECPUC, et al.) hereby submit their comments in the above-captioned proceeding. For the reasons discussed below, NECPUC et al. support the Commission's announced intentions. NECPUC et al. also urge the Commission to clarify that (1) the changes it has announced will apply to all parties holding market-based rate authority, irrespective of their participation in an approved RTO or ISO, (2) the changes to market-based rate schedules were not intended to limit the Commission's already extant power to order corrections to past charges under market-based rate tariffs where the charges thereunder were inconsistent with the filed rate and (3) that its proposed tariff changes would not result in refunds related to specific consummated market transactions established in accordance with Commission-approved RTO market power mitigation rules in effect during the period(s) the charges were imposed, except where the prices in those transactions were the result of collusion or withholding.

REASONS FOR ADOPTION OF THE PROPOSED TARIFF MODIFICATIONS

The Commission's November 20 order establishes a refund effective date of January 26, 2002 and proposes to revise all existing market-based rate tariffs and authorizations "to condition all public utility sellers' market-based rate authority to ensure that such rates remain just and

reasonable and do not become unjust or unreasonable as a result of anticompetitive behavior or abuse of market power.”¹ The order further states the Commission’s intention “to condition all new market-based rate tariffs and authorizations in a similar manner.”²

NECPUC et al. support the Commission’s action. Market-based rates are not deregulated rates and it is an affirmative obligation of the Commission to ensure that conditions justifying reliance on market forces to constrain rates within a zone of reasonableness are and remain in place. *See Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, at 1502 (D.C. Cir. 1984). *See also, San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services*, 93 FERC 61,294, at 61,997 (2000). Rates that reflect the exercise of market power or that result from collusion are not the product of a competitive market and cannot be considered just and reasonable. Therefore, it is plain enough that the Commission has the power, prospectively, to adjust rates that it finds have been inflated beyond the zone of reasonableness by the exercise of market power or through collusion between sellers. Indeed, under *Farmers Union, supra*, the Commission could not permit regulated companies to charge market-based rates without having in place a mechanism to scrutinize the competitiveness of the markets in which those companies operate.

The proposed tariff changes take this protection a logical step further. The Commission has several times stated that the market rules governing transactions within an ISO constitute the formula from which the lawful filed rate is derived. “[C]onsistent with the filed rate doctrine, the ISO already has the authority, *and is required*, to correct all prices that do not reflect operation of the NEPOOL market rules (which are the filed rate).” *New England Power Pool*, 90 FERC ¶ 61,141 at 61,425 (2000) (emphasis added). *See also NRG Power Marketing, Inc. v. New York*

¹ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 97 FERC ¶ 61,220 at 61,975 (2001).

Independent System Operator, Inc., Order Denying Complaint, 91 FERC ¶ 61,346 at 62,166 (2000). If the rates charged deviate from the rates that should be produced from proper application of the formula the Commission has the power and obligation to order a retroactive correction to ensure that only the filed rate is charged. *Id.* This is true irrespective of whether the tariff contains a refund condition and regardless of when the filed rate deviation is uncovered. *Cities and Villages of Albany and Hanover, Ill. et al.*, 61 FERC ¶ 61,037 at 61,186 (1992) (citing *North Carolina Electric Membership Corp., et al. v. Carolina Power & Light Co.*, 57 FERC ¶ 61,332 (1991)). The changes proposed in the Commission's November 20, 2001 order serve the same salutary purpose as a set of market rules by clarifying that market-based rates must, *at all times*, be just and reasonable. If the rates charged are the product of the exercise of market power or collusion, the Commission proposes that, under the terms of the revised tariff, the seller will not be permitted to retain the excess collections. In other words, charges collected as a result of collusion or the exercise of market power would violate the filed rate.

The Commission's proposed tariff change is similar to the language that was inserted into the fuel adjustment clauses of many electric utility wholesale sales tariffs. Those tariffs allowed the utility to pass through to customers the actual costs of fuel, provided that those costs were reasonable. This, the Commission held, meant that utilities could not pass imprudently incurred costs through the fuel clause because such charges would violate the filed rate. *Public Service Co. of New Hampshire*, 6 FERC ¶ 61,299 (1979); *Cities and Villages of Albany and Hanover, Ill. et al.*, 61 FERC ¶ 61,037 at 61,186 (1992). Tariffs that permit utilities to pass supracompetitive prices through to ratepayers are no less unreasonable than fuel adjustment charges that reflect imprudently incurred costs. If such charges are not already implicitly inconsistent with filed market based rate tariffs, the Commission is well within its power to modify those tariffs. It

² *Id.*

should make a finding under Section 206 that, absent such modifications, those tariffs are not just and reasonable.³

REQUEST FOR CLARIFICATION

As noted above, NECPUC et al. support the Commission's proposed modifications to existing market-based rate tariffs and its proposed inclusion of similar language in future market-based rate tariff filings. NECPUC et al. urge the Commission, however, to make several clarifications about the scope of its ruling.

First, the Commission should clarify that the tariff modifications it proposes would apply to all companies charging market-based rates, irrespective of whether they sell power within a Commission-approved RTO or ISO. The Commission order is not limited by its terms to sales made outside of an ISO or RTO, but a related order issued the same day creates some potential uncertainty about the Commission's objectives. In *AEP Power Marketing, Inc.*, 97 FERC ¶ 61,219 (2001) the Commission has proposed to modify the market power screens that determine eligibility for market-based rates, but exempts companies that participate in ISOs or RTOs that have market monitoring and mitigation authority. The assumption in the Commission's order in this docket is that the affected companies *do* have market-based rate authority. Thus, even if participation in an ISO or RTO provides automatic qualification to charge market-based rates, companies with market-based rate authority should nonetheless be required to modify their tariffs as proposed in the Commission's order. Indeed, without such a condition, the grant of

³ The Commission's November 20, 2001 order does not expressly find that existing market based rate tariffs are not just and reasonable without the protective language it has proposed. NECPUC et al. urge the Commission to make that express finding under Section 206 to avoid possible legal challenges to its authority. See *Tennessee Gas Pipeline Co.*, 76 FERC ¶ 61,022 (1996) (Commission must find existing rates, charges and terms of service unreasonable before it can order substitution of new rates).

market-based rate authority might unintentionally serve as a shield against effective antitrust relief for affected customers.⁴

Second, the Commission should clarify that its proposed changes to market-based rate schedules were not intended to limit the Commission's already extant power to order corrections to past charges under market-based rate tariffs where the charges thereunder were inconsistent with the filed rate. As noted above, the Commission has the power to ensure that all charges imposed on customers are consistent with filed rates -- even market-based rates -- and that this power allows it to correct for past overcharges irrespective of whether the filed rate has been made subject to refund.

Third, for purposes of market certainty, the Commission should clarify that its proposed tariff changes would not result in refunds related to specific consummated market transactions established in accordance with Commission-approved RTO market power mitigation rules in effect during the period(s) the charges were imposed, except where those specific transactions were the result of collusion or of withholding as defined in the Commission's November 20, 2001 Notice in this proceeding.⁵ Thus, absent collusion or withholding, prices for transactions

⁴ Under the Keough doctrine, the Supreme Court has held that while collusive conduct by companies subject to the Interstate Commerce Act is not immune from the antitrust laws, private remedies for price fixing are limited to injunctive relief. *See Keough v. Chicago & Northwestern R. Co.*, 260 U.S. 156 (1922); *Square D. Co. v. Niagara Frontier Tariff Bur.*, 476 U.S. 409, 418-9 (1986). While there is a split among the Circuits, the First Circuit has applied the Keough doctrine to the electric industry, indicating that the existence of a rate regulatory regime under the Federal Power Act may foreclose monetary damages for Sherman Act violations even where the regulated rate consisted of a market-based rate. *See Town of Norwood v. FERC*, 202 F.3d 408, 418-19 (1st Cir. 2000). Compare *City of Kirkwood v. Union Electric Co.*, 671 F.2d 1173 (8th Cir. 1982). In addition, the unilateral exercise of market power to extract high prices (as contrasted with collusive price fixing) is not, by itself, an antitrust violation, *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966), but it is one of the most traditional reasons for the use of regulation. *Tenneco Oil Co.*, 26 FERC ¶ 61,030 at 61,069 (1984); Breyer, *Regulation and Its Reform* 15-16 (1982). Thus, a tariff condition that protects the rights of customers to refunds of charges that are the product of the exercise of market power or collusion is critical to customers who may have no antitrust remedy for such conduct.

⁵ The Commission's November 20, 2001 Order defines physical and economic withholding -- means of exercising market power -- as follows:

Physical withholding occurs when a supplier fails to offer its output to the market during periods when the market price exceeds the supplier's full incremental costs. For example, physical withholding would occur when a generator declares a forced outage when its unit is not, in fact, experiencing mechanical problems, and when the market clearing price is above

charged in accordance with approved market rules would not be subject to later refund even if the Commission determined after-the-fact that the applicable market rules were flawed. However, as stated earlier, if a market monitor has market mitigation powers that FERC has found adequate and the market monitor does not detect a violation of its market rules (because of collusion, inaccurate data, etc.) FERC would have the power and obligation under the filed rate doctrine to go back and correct the charge so that it was consistent with the filed rate. *New England Power Pool, supra*, 90 FERC at 61,425. Moreover, in cases where there are no market mitigation mechanisms in place – i.e., where a seller has market-based rate authority and sells in a region where there is no ISO or RTO, FERC would decide in each case whether the seller had abused its market power. That would be a condition of the rate schedule.⁶

the unit's full incremental costs. Economic withholding occurs when a supplier offers output to the market at a price that is above both its full incremental costs and the market price (and thus, the output is not sold). For example, we would expect that, during periods of high demand and high market prices, all generation capacity would be either producing energy or supplying operating reserves. Failing to do so would be an example of economic withholding. Withholding supplies can also occur when a seller is able to erect barriers to entry that limit or prevent others from offering supplies to the market or that raise the costs of other suppliers. Examples would include denying, delaying or requiring unreasonable terms, conditions, or rates for natural gas service to a potential electric competitor in bulk power markets.

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 97 FERC ¶ 61,220 (2001), mimeo at 5-6.

⁶ The refund standard will necessarily be broader where there are no specific market rules in place to govern the behavior of sellers. There should be no distinction, however, in the treatment of sellers operating under an RTO or outside an RTO market in the case of collusion or physical or economic withholding. In either case, the Commission should attempt to ascertain how the collusion or physical or economic withholding affected the prices charged and then order a refund of the amount by which charges were inflated by the anticompetitive activity. In the collusion cases this would be similar to how price fixing damages might be calculated in an antitrust case.

Respectfully submitted,

NEW ENGLAND CONFERENCE OF PUBLIC
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Dated: January 7, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document by first class mail upon each party on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 7th day of January, 2002.

Harvey L. Reiter